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Chapter 6: Article Five: Letters of Credit

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C H A P T E R 6

Article Five: Letters of Credit

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§6.1. General. Article 5 gives Massachusetts her first statutory treatment of the subject of letters of credit, codifying some of the rules and concepts which have been developed in case law in Massachusetts and elsewhere (chiefly New York) and by the practice of members of the commercial community. Innovations have been introduced sparingly and only where the need for them seemed most pressing, and uncertainties have been eliminated in several instances. Letter of credit operations should be facilitated by the clarification and stabilization of the underlying law brought about through adoption of the Code. Article 5 is not, however, to be looked to as a panacea. The draftsmen deliberately avoided making the bold attempt to codify the whole body of law affecting letters of credit, but on the contrary, recognizing the dynamic nature of these instruments whose full capabilities have yet to be exhausted, they have expressly left room for continuing development of the governing rules and concepts.¹

Included within the scope of Article 5 are both documentary credits commonly associated with the movement of goods and also so-called "clean" credits which require the presentation by the beneficiary of no documents other than a draft or demand for payment. The Code also contemplates the issuance of credits by persons other than banks or bankers. The now forgotten but once prevalent buyer's credit, which was often tantamount to the likewise obsolete virtual or extrinsic acceptance, is left to the common law.

§6.2. Consideration: Establishment of credit. Although Article 5 does not include criteria for determining whether a particular credit is revocable or irrevocable (letters of credit issued nowadays ordinarily being clearly designated as the one or the other), Section 5-106 should nevertheless eliminate the element of uncertainty heretofore existing as to when an irrevocable credit is established as between the issuer and the beneficiary. The uncertainty arose from the rationale of cases like *Moss v. Old Colony Trust Co.*¹ and *Banco Nacional Ultramarino*

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§6.1. ¹ UCC §5-102(3).

§6.2. ¹ 246 Mass. 139, 140 N.E. 803 (1923).

v. First National Bank of Boston,² in which the courts, to the distress of some learned commentators, analyzed the relationship between the issuer and the beneficiary as one of offer by the issuer and acceptance by the beneficiary. From this it seemed to follow that letters of credit designated by their terms to be irrevocable were nevertheless subject to modification or revocation without consent of the beneficiary until the latter had accepted or acted upon the credit. Precisely what facts or circumstances would constitute action or acceptance which would bind the issuer was an open question, however unlikely it would have been for a bank to equivocate in its designation of a credit as irrevocable.

By obviating the need for consideration to establish or modify a credit,³ and then by defining clearly how or when a credit is established or modified as between the several parties, Article 5 at once eliminates a former crux of legal principle and provides a firm foundation for letter of credit operations.

§6.3. "Notation credit." Section 5-108 introduces rules to cope with some of the problems which may arise from the incorporation in a letter of credit of the so-called "negotiation clause," the most troublesome of which is that of placing the risk of loss in the event of multiple negotiations.

§6.4. Lien reservation. Section 5-110 makes it plain that one who presents documents under a credit and receives payment loses all rights to the documents and that any attempted reservation of a lien makes the documents unconfirmed. These rules are consistent with the paramount function of the letter of credit, which is to facilitate the movement of goods in trade.

§6.5. Honor or rejection: Time allowed. Section 5-112 provides a three-day period for an issuer to decide whether to pay or accept a draft presented under a credit. This is in recognition of the fact that difficult practical problems often arise in connection with the examination of documents, and also, so far as permissible delay in the payment of sight drafts is concerned, it removes the uncertainty as to what the Massachusetts law was, since Section 136 of the now-repealed Negotiable Instruments Law¹ applied by its terms only to the time after presentment allowed to a drawee to decide whether to accept a bill.

§6.6. Indemnities. Section 5-113 provides that a bank seeking to obtain payment, acceptance, negotiation or reimbursement under a credit may give indemnities to cover possible damage arising out of the fact that the documents presented are deficient in some respect. This codifies what has for many years been a common practice among banks in this country and should remove all causes for doubt as to its propriety, at least in the case of banks chartered under Massa-

² 289 Fed. 169 (D. Mass. 1923).

³ UCC §5-105.

¹ G.L., c. 107, §159.

chusetts law. This section does nothing, of course, for national banks. The Code does not touch upon the circumstances in which a bank may or possibly must¹ accept such an indemnity when it is proffered to it.

§6.7. Damages for improper dishonor. Section 5-115 (1) expressly provides that upon wrongful dishonor of a draft presented under a letter of credit, the holder may recover from the issuer incidental damages and interest in addition to the face amount of the draft less any profits realized from resale or other disposition of the goods. The Code not not impose a duty to mitigate.

§6.8. Remedy for anticipatory breach. Section 5-115 (2) marks a departure from existing Massachusetts law by expressly permitting an action for anticipatory breach of contract against an issuer which wrongfully cancels or repudiates a credit.

§6.9. Transfers and assignments. In keeping with standard banking practice, the Code provides in Section 5-116 (1) that the right to perform under a letter of credit can be transferred only if the credit is expressly designated as transferable or assignable, but unlike Section 49 of the Uniform Customs and Practice for Commercial Documentary Credits fixed by the Thirteenth Congress of the International Chamber of Commerce, the Code does not restrict the number of permissible transfers. Special rules to govern in the troublesome field of assignments of the proceeds of drafts drawn under letters of credit have been laid down in Section 5-116 (2).

§6.10. Bank insolvency. Finally, Section 5-117 deals with the problem of the insolvency of a bank holding funds or collateral for the purposes of paying drafts drawn under a documentary letter of credit by providing that such drafts are entitled to preference over depositors and general creditors of the bank to the extent of such funds or collateral. There are no Massachusetts decisions on this subject and elsewhere the law is not settled.

§6.6. ¹ See *Dixon, Irmaos & Cia. v. Chase National Bank of the City of New York*, 144 F.2d 759 (2d Cir. 1944). Compare the rule applicable as between buyer and seller in an overseas sale. UCC §2-323(2) (b).